BEFORE THE

PUBLIC SERVICE COMMISSION
OF
SOUTH CAROLINA

REBUTTAL TESTIMONY

OF

GARY D. SHAMBAUGH

EXECUTIVE VICE PRESIDENT
AUS CONSULTANTS - WEBER FICK & WILSON DIVISION

ON BEHALF OF

TOTAL ENVIRONMENTAL SOLUTIONS, INC.

SOUTH CAROLINA WATER AND SEWER UTILITIES

RELATIVE TO THE COMPANY'S REQUEST FOR GENERAL
INCREASES IN PUBLIC WATER AND SEWER RATES

DOCKET NO. 2004-90-W/S

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REBUTTAL TESTIMONY OF GARY D. SHAMBAUGH
ON BEHALF OF
TOTAL ENVIRONMENTAL SOLUTIONS, INC.

Q. PLEASE STATE YOUR NAME AND BUSINESS AFFILIATION.

A. My name is Gary D. Shambaugh. I am the Executive Vice President of AUS Consultants - Weber Fick & Wilson Division with offices located in Wormleysburg, Pennsylvania and Albuquerque, New Mexico. I am also a Vice President of AUS Consultants which has offices in Mt. Laurel, New Jersey, and Greenfield, Wisconsin.

Q. MR. SHAMBAUGH, HAVE YOU SUBMITTED DIRECT TESTIMONY IN THESE PROCEEDINGS?

A. Yes.

Q. WHAT IS THE NATURE OF YOUR REBUTTAL TESTIMONY?

A. My rebuttal testimony will address adjustments and issues raised by Commission Staff witnesses Sharon Scott and William Richardson. Throughout my rebuttal testimony I refer to "Staff". I am referring primarily to the testimony of Sharon Scott with one exception. The portion of my rebuttal testimony that addresses operating margins refers to both Ms. Scott's and Mr. Richardson's direct testimony.

Q. MR. SHAMBAUGH, DO YOU HAVE ANY GENERAL COMMENTS WITH REGARD TO STAFF'S DIRECT TESTIMONY?

A. Yes. Generally, the testimony is lacking in supporting documentation and detailed calculations.

Q. WILL YOU EXPLAIN?

A. Yes. For example, Staff apparently made numerous calculations in arriving at a rate base of $817,943 but provided no details in support of their calculations. In addition, in arriving at their position of a "negative rate base" Staff again provided no detailed explanation, calculations or documents to support their position.

Q. MR SHAMBAUGH, HAVE YOU PREPARED ANY DOCUMENTS THAT SET FORTH THE LINE ITEM REVENUE REQUIREMENT DIFFERENCES BETWEEN STAFF AND THE COMPANY POSITIONS?

A. Yes. Those documents are attached to this rebuttal testimony and identified as TESI Rebuttal Exhibits 1 and 2 for the water and sewer operations, respectfully.

Q. MR. SHAMBAUGH, WILL YOU PLEASE SET FORTH EACH OF THE STAFF'S ADJUSTMENTS NUMBERED 1 THROUGH 21, TO THE COMPANY'S FILING AND STATE THE COMPANY'S POSITION WITH REGARD TO THOSE ADJUSTMENTS?

A. Yes. I will.

Staff Adjustment No's. 1, 2 & 3

These adjustments are all interrelated and as such will be addressed as a group.

The Staff is proposing an additional $50,701 in pro forma operating revenues at present rates based upon the customer counts at December 31, 2003. The Company's more detailed analysis produces an additional $49,126 or a difference of $1,575. The Staff's position assumes that all customers added during any fiscal period will receive service on January 1 for the full twelve months, and does not reflect any losses in the number of customers and partial bills for the period. The net difference is not significant to warrant further rebuttal testimony at this time.

Staff Adjustment No. 4

The Staff has proposed that the December 31, 2002 per book level of customer tap and connection fees ($5,600) be treated as contributed property. The Staff's position assumes that the Company does not incur any costs relative to the hook up of new customers and the current fee is all capital related. As staff witness, Sharon Scott set forth in her testimony, the Company currently has a negative rate base. From an accounting standpoint, her position of a negative rate base would preclude the Company from collecting any further tap and connection fees from the customers. This issue will be further addressed in my rebuttal testimony to Staff Adjustment No. 13.

Staff Adjustment No. 5

The Staff has reduced the Company's annual water revenue requirement ($3,221) and operating expenses ($2,989) relative to the South Carolina Department of Health and Environmental Control's pass through revenues, as they are not regulated by the Commission.

The Company agrees with this adjustment, but will continue to collect the appropriate fees from the customers and remit the amounts collected to the proper agency.

Staff Adjustment No. 6

The staff adjustment ($19,043) to the Company's proposed direct salaries, wages and benefits results primarily from the loss of one (1) employee (field technician) that the Company plans to replace. The Company has experienced a net operating loss of over $267,406 in fiscal year 2003 and desperately needs rate relief before this position can be filled.

The Company would urge the Commission to recognize that full staffing of the water and sewer system is required and disallow the staff adjustment.

Staff Adjustment No. 7

The Staff has rejected the Company's actual purchased water costs ($69,489) for the twelve months ended December 31, 2003 as "not known and measurable". However, the Staff has adopted the per book level of costs ($67,168) as known and measurable. Staff has proposed a reduction in the claimed purchased water costs of $2,321. Invoices to support the purchased water costs for fiscal years 2001 through 2003, were provide to Staff as requested.

The Staff has adopted the projected number of customers as December 31, 2003 while rejecting on important element of the cost of service namely purchase water. Furthermore, the Company's operating revenue is based upon flat rates. Thus, an increase in customers usage is not reflected in the revenues, as would be the case with metered tariff rates. The purchased water claimed ($69,489) in this proceeding is known and measurable. The Commission must reject the Staff's position with regard to this adjustment.

<u>Adjustment No. 8</u>

The Company agrees that the adjustments for purchase power should not be included in these proceedings.

<u>Adjustment No. 9</u>

Based upon further review of this adjustment, it was determined that contract services were replaced only relative to the maintenance of the water and sewer systems and operation of the water system. Kace Environmental is still under contract to provide certified operation of the wastewater plant. Kace Environmental is paid $3,000 per month or $36,000.

Invoices in support of this revision to the Company's case are attached as an exhibit to my rebuttal testimony.

Adjustment No. 10

Staff has proposed an adjustment to Insurance Expense that decreases the Company's proposed adjustment by $4,341. Staff has not provided a basis or detailed calculations in support of their adjustments to the Company's claimed operating expenses related to insurance. Therefore, it is not possible to assess the validity of Staff's adjustments at this time.

Adjustment No. 11

The Staff's adjustments to the Company's affiliate charges is comprised of several major areas. I will address each as follows:

Allocation Factors

The Staff took a simplistic approach to the development of the allocation factors. They assumed that all services to all customers is relative and proportionate. Thus, the number of customers in South Carolina would be relative to the total customers and cost of services provided in South Carolina to the number of TESI customers and total system wide costs in all states.

This is a critical error in the Staff's position regarding allocation factors. For example, the Pennsylvania customers are billed from the office in Du Bois, PA. Under the Staff's methodology of calculating allocation factors, customers in Pennsylvania will pay for the South Carolina customers billing and collection costs. Many other costs will also be subsidized by other states as a result of the Staff's erroneous allocation methodology.

The Company has provided an extensive study that specifically allocates components by the cost of service provided. To avoid the intra-state subsidization of rates, the Company would urge the Commission to reject the Staff's flawed methodology and adopt the Company's study.

Of the total affiliated charges ($1,469,901) incurred in fiscal year 2002, the Company allocated approximately $56,793 or 3.9% to South Carolina.

Corporate Office Space

Staff has totally removed any cost for corporate office space since in Staff's opinion, the Company has negative rate base. The negative rate base issue will be addressed at Adjustment No. 13. They have allowed $440 in facilities operating costs.

Staff has recommended to this Commission to approve the recovery of $440 through customer's rates or approximately $.049 per square foot of office space. This is an unreasonable position. The Company provides an office building and storage (8,947 square feet) with heating, lighting and property taxes. The office space houses management, engineering, customer billing, customer service, accounting and finance and record storage.

The office building has a fair market value in the range of $5.00 to $6.00 per square foot. The Company has requested $1,582 from South Carolina operations to cover the cost of housing these functions.

Staff has ignored commons sense in arriving at their position. On a stand alone basis housing the management operations for the South Carolina operations would be considerably more than the $1,582 that is being claimed by the Company in this proceeding.

Corporate Office - Operating Costs

Staff's total corporate costs amounted to $634,538 with 2.43% or $15,419 allocated to South Carolina. Staff provided no support for their reduction in expenses ($59,815) in the study. The Company has provided all invoices necessary to support of the fiscal year corporate costs. Again, the Staff's proposal to under-allocate this affiliated service charge to South Carolina improperly places the burden of cost recovery to other customers in other states.

The 5% coverage factor was added to allow for the possibility of the non-recovery of affiliate operating costs. The South Carolina operations owes a considerable amount of affiliate costs to the parent Company. Interest costs are not assessed at this time. The South Carolina water and sewer operations are currently not sustainable operations and in danger of failing. Thus, the 5% coverage is in recognition of the risk in operations and the lack of accrued interest on due and payable costs.

The Company would recommend the adoption of the Company's supportable claim of $27,771 applicable to costs incurred on behalf of South Carolina customers.

Corporate Salaries, Wages & Benefits

Staff increased corporate salaries, wages and benefits to $867,012 as of May 2004. However, it appears that Staff only allocated 2.26% ($19,554) of the administrative functions to South Carolina. This approach even deviates from the Staff's already flawed allocation methodology which would require 2.43% or $21,068 to be allocated to South Carolina.

Based upon the affiliated charges study approximately 3.8% or $32,946 in administrative salaries and wages should be allocated to South Carolina.

Corporate Costs - Summary

The Staff contends and sets forth through a flawed methodology that it would not be unreasonable for TESI to lease an office, provide corporate management, customer related functions, corporate operating costs, such as heat, light, telephone, postage, etc. for a total annual cost of $34,044.

The Company provided an affiliate services charges study, including supporting invoices for all charges, that sets forth specific allocations to each state and utility system based upon the services provided. The results of that study indicated that South Carolina's portion of the 2002 corporate costs are a meager $52,565.

It is imperative for the Commission to test the reasonableness of the Company's claim. As an example, customer billing alone on a stand alone basis would be in the range of $10,000 to $15,000 per year on a contract basis. Staff has allowed $16,242 for corporate salaries to handle customer billing, customer service, engineering, accounting, auditing, etc. It is my opinion that the Staff's allowance for these items is so unreasonably low as to be unreasonable *per se*.

The Staff's position with regard to the corporate office space is an attempt to have other TESI customers pay for the office.

The Company's proposed affiliate charges ($52,565) are fair, just and reasonable and could not be secured by the South Carolina utilities for the proposed annual charge of $52,565. It is important to note that audited affiliate charges for fiscal year 2003 amount to $61,082.

The Staff's affiliated charges and methodology is neither supported by the record evidence in this proceeding, nor accepted utility accounting principles. The Commission should adopt the

Company's affiliate charges and methodology as the only one supported by the record in this proceeding.

Adjustment No. 12

It appears that Staff has allowed approximately $164,025 in rate case costs through May, 2004 to be amortized over five (5) years.

The Staff's approach ignores the fact that a majority of the Company's work in responding to discovery requests, preparing testimony, and preparing for the actual hearing in this case will and has occurred during the two month's leading up to the August 4 hearing. In order to reflect this reality, rate case costs must be updated through the end of the case.

Adjustment No. 13

Staff has eliminated the Company's per book ($5,821) and pro forma ($101,701) annual depreciation claims due to their claim that the Company has "negative rate base".

Staff's methodology is flawed and must be rejected by the Commission for several reasons as follows:

Purchase Price

TESI paid $3,450,000 for the acquisition of utilities in six (6) states. However, the purchase price must be adjusted to reflect the rehabilitation costs as prescribed by the National Association of Regulatory Utility Commissioners Uniform System of Accounts, Class A-1996, Page 26, Accounting Instructions, Part C, as states:

"If property acquired in the purchase of an operating unit or system is in such physical condition when acquired that it is necessary substantially to rehabilitate it in order to bring the property up to the standards of the utility, the cost of such work, except replacements, shall be accounted for as a part of the purchase price of the property."

Staff has failed to recognize that the total purchase price is now approaching $20 million and any acquisition adjustment would be positive and would not require any downward adjustment in the book value of the assets. Certainly any allocation of plant based upon the number of customers is not appropriate and irrelevant in this proceeding.

Contributed Property

Staff has considered $351,456 in lot enhancement fees to be contributed property. This approach is flawed for several reasons:

1. The Staff's adjustment appears to be based upon enhancement fee *billing*. Even though the Company billed for a certain amount of enhancement fees in 2001 and 2002, it collected only a fraction of the billed amount. Actual 2003 collections by TESI are $ approximately $42,941and the Company books accurately reflect this fact as a "Bad Debt entry on the Company's books. Any enhancement fee calculation must be adjusted to reflect that the majority of the amount billed was never collected.

2. The Staff's adjustment incorrectly assumes that the Company collected enhancement fees in 2003. Any enhancement fees were collected by Total Environmental Solutions Management of Louisiana during 2003.

Moreover, the courts have previously decided that lot enhancement fees are not relative to utility operations. The Company's 2003 audit supports this opinion. The fees are set forth therein as non-regulated revenue. Any consideration or inclusion of lot enhancement fees are contrary to the courts decision, accounting practices and principles and ratemaking applications.

Staff has further reduced rate base by applying $19,300 in tap fees to help justify a "negative rate base".

Both positions could be construed as retro-active ratemaking at its worst. Not only does the Staff desire to reclassify revenues from prior periods and approved tariffs, they wish to apply those elements to a manufactured rate base without accounting support.

To magnify the injustice and the inappropriateness of Staff's position, TESI has rehabilitated and/or replaced plant totaling $174,757 for which they have not had an opportunity to recover the investments. TESI borrowed the funds to make the improvements on good faith and now Staff recommends $0 annual depreciation expense and $0 interest cost in these proceedings.

Staff presented an alternate rate base of $817,943 but provided no support for their calculations. They also provided the annual depreciation expense ($15,160) and allowable interest expense ($15,678). The Staff opines that the Company "did not pay $817,943 for the utility".

The Staff in their eagerness to erode the Company's measures of value has confused the "purchase price" and the value of the assets for ratemaking purposes. Staff allocated their purchase price by the relative number of customers which has no bearings on the investment in the ground in South Carolina. Should the Commission adopt the Staff's proposed "negative rate base", serious consequences will arise from this action as follows:

- The Company will not be able to recover any future tap fees or enhancement fees since there will be no cost basis.
- The Company will not be able to recover principal and interest from the funds invested in capital.
- No financing will be available for future projects, and
- The "Negative rate base" will cause a financial impairment on the consolidated financial statements. This will be absolutely unacceptable to the Company.

Staff has totally rejected the Company's original cost studies without basis or merit. These studies accurately set forth the surviving utility asset values when first dedicated to public service. Those assets are being consumed as service is provided to the customers. The Staff's rejection of any annual depreciation claim as a cost of service is contrary to sound ratemaking practices.

The Company would strongly advise the Commission to reject the Staff's position with regard to the original cost studies and adopt the Company's original cost studies, annual depreciation expense claims and incorporate the depreciation expense in the Company's annual revenue requirements. The adoption of the Company's position relative to rate base and annual depreciation expense will produce long term financial benefits to the customers with the possible avoidance of future rate case and/or future mitigation of rate increases.

Adjustment No. 14

The Company does not disagree with this adjustment.

Adjustment No. 15

The Company does not disagree with these adjustments.

Adjustment No. 16

The Company and Staff agree on this adjustment.

Adjustment No. 17

The Company does not disagree with the utilization of the current gross receipts factors; however, the final adjustment for an annual revenue requirement must be based upon Commission approved pro forma revenues.

Adjustment No. 18

The Company disagrees with the Staff's position regarding negative rate base. An operating margin and interest expense component must be considered in the annual revenue requirements to allow for sufficient revenues to meet debt service requirements.

The Company disagrees with the Staff's adjustment regarding interest expense.

Adjustment No 19

The Company does not disagree with the Staff, that annual revenue must be increased by approximately $538,490. The Company disagrees with several of the methods by which the Staff has arrived at their revenue requirements.

The Staff's methodologies are contrary to sound ratemaking principals and detrimental to the long term financial viability of the Company and requires the customers to pay income taxes on excessive margins, and eliminates annual depreciation expense (non-taxable) that the Company needs to support the rehabilitation, repair and replacement of $5.5 million in fixed capital plant.

Adjustment No. 20

The Company does not disagree with the utilization of the current gross receipts factors; however, the final adjustment for an annual revenue requirement must be based upon Commission approved pro forma revenues.

Adjustment No. 21

The calculation for the Company's state and federal tax liabilities should be based upon the net operating margin established by this Commission.

The Company disagrees with the Staff's income tax calculations since they do not reduce the claim for interest expense and the taxes are based upon excessive margins.

Q. MR. SHAMBAUGH, CAN YOU PUT THE MAGNITUDE OF THE STAFF'S PROPOSED ADJUSTMENTS AS THEY COMPARE TO THE COMPANY'S PROPOSED ADJUSTMENTS INTO PERSPECTIVE?

A. Yes. Based upon the Staff's proposed adjustments, and pro forma revenue requirement the Company will lose another $133,022 during pro forma 2004 operations, under its current rate structure. The Company's adjusted test year losses are $238,045 more than this, at $371,067. To fully appreciate the vast difference between the Staff and Company conclusions, the Commission only needs to review the Companies audited financial statements for 2002 and 2003 (attached hereto as Exhibits 3 and 4). Those statements show that the Company lost $231,137 in South Carolina in 2002, and $267,406 in 2003. In viewing these audited losses, the Commission must remember that they are both unadjusted, and based upon financial, and not utility accounting principles. For these two reasons, they actually *understate* the Company's losses at Foxwood Hills for ratemaking purposes. The difference between the Company's actual losses and the Staff's proposed Company losses are so vast that they conclusively establish the invalidity of the Staff's entire position in this case.

Q. DO YOU HAVE ANY FURTHER COMMENTS REGARDING THE STAFF EXHIBITS?

A. Yes. Staff Audit Exhibit A-3, does not reflect all operating costs attributable to South Carolina. Audit Exhibit A-3 does not include an allocation of affiliate charges or general liability insurance.

Audited financial statements set forth the operating losses in South Carolina as follows:

Fiscal Year	N.O.L.
2001	$193,497
2002	231,137
2003	267,406

In addition, TESI projects an operating loss in 2004 of approximately $260,000 based upon statements of operations for the six (6) months ended June 2004.

Q. MR. SHAMBAUGH, DO YOU HAVE AN OPINION WITH REGARD TO THE FINANCIAL VIABILITY SHOULD THE COMMISSION ADOPT THE STAFF'S PORTION IN THIS PROCEEDING?

A. TESI, South Carolina operations will not be nor will ever be financially viable.

Q. WILL YOU PLEASE EXPLAIN?

A. Yes. It appears the Staff does not fully appreciate the financial ramification of their proposed adjustments in these proceedings. Staff has proposed several unsupportable operating adjustments, contrived a "negative rate base" by employing unacceptable and flawed methodologies, setting forth operating margins that are unreasonable that TESI would never ask this Commission to approve and set forth an income tax projection that is flawed and not required.

In addition, Staff has ignored the need for capital recovery and the establishment of a sound financial basis to facilitate future financing. A "negative rate base" in South Carolina will be a detriment to the South Carolina operations and will be a detriment to TESI's consolidated operations in the remaining states.

TESI does not have the financial where with all to subsidized operations in South Carolina. After incurring combined operating losses of over $822,040 to date and faced with the prospect of another loss in 2004 in South Carolina, TESI will take aggressive actions to protect the operations in the remaining states should the Commission adopt the Staff's position regarding the future financial position of the South Carolina operations.

Q. MR. SHAMBAUGH, DO YOU HAVE AN OPINION AS TO HOW THE SOUTH CAROLINA UTILITIES CAME INTO SUCH A NEGATIVE FINANCIAL AND OPERATIONAL CONDITION?

A. Yes. The customer's rates have been well below the actual cost of service. Also, it appears that the regulatory agencies did not employ the proper oversight necessary to protect the customers.

Q. WOULD YOU PLEASE SITE THE AREAS OF REGULATORY OVERSIGHT THAT YOU HAVE DETERMINED AS DETRIMENTAL TO THE LONG TERM FINANCIAL VIABILITY OF THE UTILITIES?

A. Yes. *Customer Rates* - Obviously, the initial rates were not based upon the cost of providing service. Those rates were in effect until 1996. The rates established in 1996 were still below cost of service and employed customer tariff rate designs that are discriminatory within the classes.

Financial Statements - Annual reports were filed with the Commission in 1991 and 1992 that removed all fixed capital asset costs and accrued depreciation elements from the balance sheet without a proper accounting basis or explanation. No one except TESI raised any questions regarding this issue.

Escrow Account - The documents filed in this case are self-explanatory. The current value of the escrow account today would be approaching $400,000 or more.

Regulatory Oversight - The water and sewer systems were neglected for over twenty (20) years by the previous owners. Both the water and sewer systems are suffering from deferred maintenance.

Customer Growth - No financial plans or resources are available for customer growth. While the customer growth is a positive to the development, the additional customers will place an added burden on the fixed capital assets and expedite the need for replacement or expansion. Funds should have been historically approved in customer rates for an annual depreciation expense charge which would have supported annual maintenance, renewals and replacements of plant, and strengthened the long term financial picture of the utilities.

Q. IF THE COMMISSION APPROVES THE STAFF'S POSITION IN THESE PROCEEDINGS, WILL THE COMPANY BE ABLE TO DEMONSTRATE FINANCIAL VIABILITY DURING THE DHEC PERMIT RENEWAL PROCESS?

A. No.

Q. MR. SHAMBAUGH HAVE YOU PREPARED AN EXHIBIT THAT DEMONSTRATES THE TOTAL EFFECT OF STAFF'S PROPOSED ADJUSTMENTS TO TESI'S OVERALL FINANCIAL CONDITION?

A. Yes. TESI Rebuttal Exhibit No. 5 demonstrates that the Staff is recommending to the Commission a combined revenue increase of $134,384 before margin or income taxes. TESI experienced a combined fiscal year 2003 operating loss in South Carolina of $267,406.

If the commission approves the Staff's position, TESI will still experience an operating loss of approximately $133,022 as previously mentioned in my testimony.

Q. MR. SHAMBAUGH WILL THE PROPOSED STAFF ADJUSTMENTS CREATE ADDITIONAL FINANCIAL HARM TO THE COMPANY?

A. Yes. TESI Rebuttal Exhibit No. 5 clearly demonstrates that the Staff's additional adjustments totaling ($545,513) that proposes the confiscation of the Company's property and their retroactive ratemaking positions will create a negative financial impact to the Company. The total financial effect ($678,535) to the Company will be a negative impact to the financial position of the Company. The effect of those adjustments added to the combined operating losses in 2001-2003 totaling ($692,040) will place these systems in position from which a financial recovery seems highly unlikely. Any future long term financing in support of capital projects will be impossible.

Q. MR. SHAMBAUGH, HAVE YOU PREPARED AN ANALYSIS TO DEMONSTRATE TO THE COMMISSION THE OPERATING MARGIN REQUIRED BASED UPON STAFF'S PROPOSED REVENUE INCREASE FOR THE SOUTH CAROLINA OPERATIONS TO MEET THEIR OBLIGATIONS?

A. Yes. TESI Rebuttal Exhibit 5 demonstrates that an operating margin of approximately 18% to 20% will be required just for TESI to recover their basic operating costs. No funds would be available for capital renewals, replacements, emergency needs, finance debt, or to demonstrate the financial viability of a going concern.

Q. IS THIS A DIRECT RESULT OF THE STAFF ADJUSTMENTS?

A. Yes. Staff has been very unrealistic with their assessment of the Company's operating costs and ongoing liabilities.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY AT THIS TIME?

A. Yes. It does.

Total Environmental Solutions, Inc.
South Carolina Water System

Comparison of the Company's Adjustments to PSC's Adjustments
Operating Revenues at December 31, 2003 [Present Rates]

Operating Revenues	Year Ended 12/31/02	Per Company Adjustments	Per Company Total	Per PSC Staff Adjustments		Per PSC Staff Total	Difference
Flat Rate Revenue:							
Residential	$67,964	($11,569)	$56,395				
Commercial	0	28,683	28,683				
RV	0	20,034	20,034				
Total Flat Rate Revenue	$67,964	$37,148	$105,112	$37,994	1]	$105,958	$846
Customers' Penalties	$2,309		$2,309			$2,309	$0
Pass Through Fees	3,221		3,221	($3,221)	3]	0	(3,221)
Tap & Connection Fees	2,700	$300	3,000	(2,700)	2]	0	(3,000)
Total Operating Revenues	$76,194	$37,448	$113,642	$32,073		$108,267	($5,375)

PSC Staff's Adjustments:
1] Adjustment #1, #2 and #3 - to reflect flat rate revenue based on the 2003 number of customers.
2] Adjustment #4 to reflect the removal of tapping fees. Tapping fees are classified as CIAC and are a reduction from rate base.
3] Adjustment #5 to reflect the removal of Pass Through Fees. These fees are a separate charge.

Total Environmental Solutions, Inc.
South Carolina Water System

Comparison of the Company's Adjustments to PSC's Adjustments
Operating Expenses, Taxes & Other Deductions for the Year Ended December 31, 2003 [Pro Forma]

Account Description	Year Ended 12/31/2002	Per Company Adjustments	Per Company Total	Per PSC Staff Adjustments		Per PSC Staff Total	Difference
Operating Expenses:							
Salaries & Wages, Benefits & Payroll Taxes	$28,854	$28,078	$56,932	$18,924	1]	$47,778	($9,154)
Purchased Water	67,168	2,321	69,489	0	2]	67,168	(2,321)
Purchased Power	6,389	8,000	14,389	(787)	3]&8]	5,602	(8,787)
Materials & Supplies	13,737		13,737			13,737	0
Contract Services - Operations	2,405	(2,405)	0	(2,405)	4]	0	0
Contract Services - Engineering	2,107		2,107			2,107	0
Contract Services - Legal	21,746		21,746	(180)	8]	21,566	(180)
Contract Services - Testing	476		476			476	0
Contract Services - Other	6,674		6,674			6,674	0
Rentals - Equipment	8,546		8,546			8,546	0
Transportation Expense	3,270		3,270			3,270	0
Bad Debts Expense	485		485			485	0
Computer Expenses	974		974			974	0
Dues & Subscriptions	554		554			554	0
Office Supplies & Expenses	1,933		1,933	(121)	8]	1,812	(121)
Postage & Shipping	2,429		2,429			2,429	0
Telecommunications Expenses	1,577		1,577			1,577	0
Insurance - Liability, Vehicle, W.C., Etc.	0	11,531	11,531	7,190	5]	7,190	(4,341)
Affiliated Charges	0	28,915	28,915	17,926	6]	17,926	(10,989)
Rate Case Costs	10,205	29,795	40,000	11,161	7]	21,366	(18,634)
Total Operating Expenses	$179,529	$106,235	$285,764	$51,708		$231,237	($54,527)
Taxes & Other Deductions:							
Depreciation Expense	$4,226	$38,308	$42,534	($4,226)	10]	$0	($42,534)
Income Taxes	0	32,866	32,866	70,839	14]	70,839	37,973
PSC Utility Assessments	1,613	4,357	5,970	1,423	13]	3,036	(2,934)
SC DEHC Fee	3,014		3,014	(2,989)	9]	25	(2,989)
Oconee City Assessment	510		510			510	0
Proprerty Taxes	2,626	(2,509)	117	(2,509)	11]	117	0
Interest Expense	0	7,129	7,129		12]	0	(7,129)
Total Taxes & Other Deductions	$11,989	$80,151	$92,140	$62,538	$0	$74,527	($17,613)
Total Revenue Deductions	$191,518	$186,386	$377,904	$114,246	$0	$305,764	($72,140)

PSC Staff's Adjustments:
1] Adjustment #6 to reflect annualized salaries & wages. Eliminated a Field Technician.
2] Adjustment #7 to reflect the increase in purchased water costs.. Eliminate based on fluctuations in water usage.
3] Adjustment #8 to reflect the increase in purchased power costs. Eliminated because the booster stations have not been purchased.
4] Adjustment #9 to reflect elimination of contract operation expenses. Agrees with Company's adjustment.
5] Adjustment #10 to reflect the increase in insurance costs based on Company provided 2004 data.
6] Adjustment #11 to reflect the increase in affiliated services expenses.
7] Adjustment #12 to reflect the increase in rate case expenses. Amortize costs of $106,828 over five [5] years.
8] Adjustment #15 to reflect non-allowable expenses.
9] Adjustment #5 to reflect removal of fees that are pass through costs.
10] Adjustment #13 to reflect removal of depreciation expense due to negative rate base.
11] Adjustment #16 to reclassify to sewer operations. Agrees with the Compay's adjustment.
12] Adjustment #18 to reflect removal of interest expense due to negative rate base.
13] Adjustment #17 & #20 to reflect PSC Utility Assessments based on proposed revenue level.
14] Adjustment #21 to reflect income taxes based on proposed revenue level.

Total Environmental Solutions, Inc.
South Carolina Sewer System

Comparison of the Company's Adjustments to PSC's Adjustments
Operating Revenues at December 31, 2003 [Present Rates]

Operating Revenues	Year Ended 12/31/02	Per Company Adjustments	Per Company Total	Per PSC Staff Adjustments		Per PSC Staff Amount	Difference
Flat Rate Revenue:							
Residential	$131,278	($50,941)	$80,337				
Commercial	0	42,823	42,823				
RV	0	20,096	20,096				
Total Flat Rate Revenue	$131,278	$11,978	$143,256	$12,707	1]	$143,985	$729
Customers' Penalties	$672		$672			$672	$0
Tap & Connection Fees	2,900	$1,900	4,800	($2,900)	2]	0	(4,800)
Total Operating Revenues	$134,850	$13,878	$148,728	$9,807		$144,657	($4,071)

PSC Staff's Adjustments:
1] Adjustment #1, #2 and #3 to reflect flat rate revenue based on the 2003 number of customers.
2] Adjustment #4 to reflect the removal of tapping fees. Tapping fees are classified as CIAC and are a reduction from rate base.

Total Environmental Solutions, Inc.
South Carolina Sewer System

Comparison of the Company's Adjustments to PSC's Adjustments
Operating Expenses, Taxes & Other Deductions for the Year Ended December 31, 2003 [Pro Forma]

Account Description	Year Ended 12/31/2002	Per Company Adjustments	Per Company Total	Per PSC Staff Adjustments		Per PSC Staff Total	Difference
Operating Expenses:							
Salaries & Wages, Benefits & Payroll Taxes	$18,427	$37,366	$55,793	$27,477	1]	$45,904	($9,889)
Sludge Removal	8,805		8,805			8,805	0
Purchased Power	9,516	12,000	21,516	0	2]	9,516	(12,000)
Chemicals	4,210		4,210			4,210	0
Materials & Supplies	4,242		4,242			4,242	0
Contract Services - Operations	41,427	(41,427)	0	(41,427)	3]	0	0
Contract Services - Engineering	716		716			716	0
Contract Services - Legal	19,173		19,173			19,173	0
Contract Services - Testing	3,376		3,376			3,376	0
Contract Services - Other	2,431		2,431			2,431	0
Rentals - Equipment	5,500		5,500			5,500	0
Transportation Expense	4,760		4,760			4,760	0
Bad Debts Expense	2,295		2,295			2,295	0
Dues & Subscriptions	143		143			143	0
Office Supplies & Expenses	711		711			711	0
Postage & Shipping	30		30			30	0
Penalties	4,900	(4,900)	0	(4,900)	8]	0	0
Telecommunications Expenses	772		772			772	0
Insurance - Liability, Vehicle, W.C., Etc.	0	11,300	11,300	6,975	4]	6,975	(4,325)
Affiliated Charges	0	28,335	28,335	17,487	5]	17,487	(10,848)
Rate Case Costs	8,605	31,395	40,000	(2,629)	6]	5,976	(34,024)
Total Operating Expenses	$140,039	$74,069	$214,108	$2,983		$143,022	($71,086)
Taxes & Other Deductions:							
Depreciation Expense	$1,595	$63,393	$64,988	($1,595)	7]	$0	($64,988)
Income Taxes	0	28,020	28,020	78,465	12]	78,465	50,445
PSC Utility Assessments	1,065	1,740	2,805	1,527	11]	2,592	(213)
Proprerty Taxes	2,626	2,509	5,135	2,509	9]	5,135	0
Interest Expense	0	7,129	7,129	0	10]	0	(7,129)
Total Taxes & Other Deductions	$5,286	$102,791	$108,077	$80,906		$86,192	($21,885)
Total Revenue Deductions	$145,325	$176,860	$322,185	$83,889		$229,214	($92,971)

PSC Staff's Adjustments:
1] Adjustment #6 to reflect annualized salaries & wages. Eliminated a Field Technician.
2] Adjustment #8 to reflect the increase in purchased power costs. Eliminated because the booster stations have not been purchased.
3] Adjustment #9 to reflect elimination of contract operation expenses. Agrees with Company's adjustment.
4] Adjustment #10 to reflect the increase in insurance costs based on Company provided 2004 data.
5] Adjustment #11 to reflect the increase in affiliated services expenses.
6] Adjustment #12 to reflect the increase in rate case expenses. Amortize costs of $29,882 over five [5] years.
7] Adjustment #13 to reflect removal of depreciation expense due to negative rate base.
8] Adjustment #14 to reflect removal of a civil penalty. Agrees with Company's adjustment.
9] Adjustment #16 to reclassify to sewer operations. Agrees with the Compay's adjustment.
10] Adjustment #18 to reflect removal of interest expense due to negative rate base.
11] Adjustment #17 & #20 to reflect PSC Utility Assessments based on proposed revenue level.
12] Adjustment #21 to reflect income taxes based on proposed revenue level.

TESI REBUTTAL EXHIBIT 3

TOTAL ENVIRONMENTAL SOLUTIONS, INC. AND SUBSIDIARY
Baton Rouge, Louisiana

CONSOLIDATED FINANCIAL REPORT

December 31, 2003

TOTAL ENVIRONMENTAL SOLUTIONS, INC. AND SUBSIDIARY

Baton Rouge, Louisiana

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December 31, 2003

FAULK WINKLER LLC
CPAs • Business Advisors • Wealth Managers

INDEPENDENT AUDITORS' REPORT

Board of Directors
Total Environmental Solutions, Inc. and Subsidiary
Baton Rouge, Louisiana

We have audited the accompanying consolidated balance sheet of **TOTAL ENVIRONMENTAL SOLUTIONS, INC. AND SUBSIDIARY** (a Louisiana corporation and wholly owned subsidiary of South Louisiana Electric Cooperative Association) as of December 31, 2003 and the related consolidated statements of operations, changes in stockholder's equity, and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of **TOTAL ENVIRONMENTAL SOLUTIONS, INC. AND SUBSIDIARY** as of December 31, 2003 and the results of its operations, changes in stockholder's equity and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the financial statements, the Company has suffered recurring losses from operations, has negative working capital, has violated certain covenants in its debt agreements that caused default on its loans, and has an accumulated deficit that raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 2. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Faulk & Winkler, LLC

Certified Public Accountants

Baton Rouge, Louisiana
June 25, 2004

6811 Jefferson Highway • Baton Rouge, LA 70806 • (225) 927-6811 • Facsimile: (225) 932-0000
1404 S. Burnside Avenue • Gonzales, LA 70737 • (225) 647-6811

TOTAL ENVIRONMENTAL SOLUTIONS, INC. AND SUBSIDIARY

Baton Rouge, Louisiana

CONSOLIDATED BALANCE SHEET

December 31, 2003

ASSETS

CURRENT ASSETS	
Cash	$ 124,431
Accounts receivable, net	743,137
Amount due from sale of property	320,343
Prepaid expenses	675,783
Total current assets	1,863,694
PROPERTY - net	20,531,180
DEFERRED CHARGES - net	270,738
DEFERRED INCOME TAXES	734,000
OTHER ASSETS	7,515
Total assets	$ 23,407,127

LIABILITIES AND STOCKHOLDER'S EQUITY

CURRENT LIABILITIES	
Outstanding checks in excess of bank balance	$ 226,059
Accounts payable and accrued expenses	819,340
Due to parent company (SLECA)	628,122
Customer deposits	442,690
Note payable	608,629
Long-term debt	16,788,109
Total current liabilities	19,512,949
STOCKHOLDER'S EQUITY	
Capital stock (no par value common stock 100,000 shares authorized, 10,000 shares issued and outstanding)	100,000
Additional paid-in capital, as restated	5,981,227
Accumulated deficit, as restated	(2,187,049)
Total stockholder's equity	3,894,178
Total liabilities and stockholder's equity	$ 23,407,127

The accompanying consolidated notes to financial statements are an integral part of this statement.

TOTAL ENVIRONMENTAL SOLUTIONS, INC. AND SUBSIDIARY

Baton Rouge, Louisiana

CONSOLIDATED STATEMENT OF OPERATIONS

For the year ended December 31, 2003

OPERATING REVENUES	
Water	$ 3,440,916
Wastewater	6,339,781
Contract services	97,200
Total operating revenues	9,877,897
OPERATING EXPENSES	
Water	3,226,864
Wastewater	4,580,262
General and administrative	2,355,803
Total operating expenses	10,162,929
Operating loss before other income (expense)	(285,032)
OTHER INCOME (EXPENSE)	
Interest income	3,066
Interest expense	(560,273)
Gain on sale of property	217,058
Other income	8,413
Total other expense, net	(331,736)
Net loss before income taxes	(616,768)
DEFERRED TAX BENEFIT	68,000
Net loss	$ (548,768)

The accompanying consolidated notes to financial statements are an integral part of this statement.

Exhibit C

TOTAL ENVIRONMENTAL SOLUTIONS, INC. AND SUBSIDIARY

Baton Rouge, Louisiana

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDER'S EQUITY

For the year ended December 31, 2003

	Capital Stock		Additional Paid-in	Accumulated	Total Stockholder's
	Shares	Amount	Capital	Deficit	Equity
BALANCE - DECEMBER 31, 2002	10,000	$ 100,000	$ 641,495	$ (1,699,022)	$ (957,527)
Prior period adjustment	-	-	5,150,414	60,741	5,211,155
BALANCE - DECEMBER 31, 2002, as restated	10,000	100,000	5,791,909	(1,638,281)	4,253,628
Contributed capital for 2003	-	-	189,318	-	189,318
Net loss for 2003	-	-	-	(548,768)	(548,768)
BALANCE - DECEMBER 31, 2003	10,000	$ 100,000	$ 5,981,227	$ (2,187,049)	$ 3,894,178

The accompanying consolidated notes to financial statements are an integral part of this statement.

TOTAL ENVIRONMENTAL SOLUTIONS, INC. AND SUBSIDIARY

Baton Rouge, Louisiana

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended December 31, 2003

CASH FLOWS FROM OPERATING ACTIVITIES	
Net loss	$ (548,768)
Adjustments to net loss:	
Depreciation expense	960,657
Amortization expense	69,744
Gain on sale of property	(217,058)
Deferred income tax benefit	(68,000)
Change in operating assets and liabilities:	
Current assets	(97,749)
Accounts payable and accrued expenses	(1,217,944)
Net cash used by operating activities	(1,119,118)
CASH FLOWS FROM INVESTING ACTIVITIES	
Proceeds on sale of asset	305,000
Property acquisitions and deferred charges	(4,477,058)
Net cash used by investing activities	(4,172,058)
CASH FLOWS FROM FINANCING ACTIVITIES	
Increase in outstanding checks in excess of bank balance	226,059
Increase in note payable, net	224,046
Proceeds from the issuance of debt	5,140,875
Retirement of long-term debt	(517,327)
Capital contributions from parent company	189,318
Net cash provided by financing activities	5,262,971
Net decrease in cash	(28,205)
CASH	
Beginning of year	152,636
End of year	$ 124,431

The accompanying consolidated notes to financial statements are an integral part of this statement.

TOTAL ENVIRONMENTAL SOLUTIONS, INC. AND SUBSIDIARY
Baton Rouge, Louisiana

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Operations

Total Environmental Solutions, Inc. and Subsidiary, (TESI) is a wholly owned subsidiary of South Louisiana Electric Cooperative Association (SLECA). TESI was chartered in 2000 to purchase the assets of a water and wastewater utility through the Bankruptcy Court of the Middle District of Louisiana. TESI provides water and wastewater services to customers in Louisiana, Mississippi, Tennessee, North Carolina, South Carolina, and Pennsylvania. During 2003, Total Environmental Solutions Management Company, Inc. (TESM) was formed as TESI's wholly-owned subsidiary.

Basis of presentation and consolidation

The consolidated financial statements include the accounts of TESI and TESM. All intercompany transactions and balances between these two companies have been eliminated.

However, the consolidated financial statements do not include any activity of SLECA and intercompany transactions have not been eliminated. See Note 11.

Method of accounting

Assets, liabilities, revenues and expenses are recognized on the accrual method of accounting.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect reported amounts and related disclosures of the financial statements. Actual results could differ from those estimates. Estimates are used primarily when accounting for the allowance for doubtful accounts, regulatory assets and deferred charges, depreciation and deferred taxes.

Cash

For purposes of the statement of cash flows, all highly liquid investments purchased with maturities of three months or less are considered to be "cash equivalents." There are no cash equivalents at December 31, 2003. Additionally, cash is not currently segregated for customer deposits.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Accounts receivable

Revenues are recognized when services are rendered to customers. Accounts receivable is stated at the amount management expects to collect from outstanding balances. TESI uses the allowance method to account for doubtful accounts receivable. The allowance is established through a provision for bad debts charged to expense. Accounts receivable are charged against the allowance for doubtful accounts when management believes that the collectibility of an account is unlikely.

Allowance for funds used during construction (AFUDC) and interest capitalized

AFUDC represents the estimated debt and equity costs of capital funds that are necessary to finance the construction of new regulated facilities. While cash is not realized currently from such an allowance, it increases the revenue requirement over the service life of the plant through a higher rate base and higher depreciation expense. However, TESI's rates do not include such a provision since capital improvements have been made strictly from debt issuance. As a result, no such provision for equity investment has been recorded. Accordingly, interest costs are capitalized in accordance with standard interest capitalization requirements.

Utility plant and other property

In accordance with regulatory accounting, property is stated at cost, less accumulated depreciation. Additionally, recognition has been provided for acquisition adjustments related to original costs of plant-in-service for utility plants in Pennsylvania as provided through the ratemaking process by the Pennsylvania Public Utility Commission. All property recorded is included in rates. Depreciation expense is computed on the straight-line method, as approved by regulatory authorities in the ratemaking process, over the estimated useful lives of depreciable assets for financial statement purposes, whereas accelerated methods are used for income tax purposes. Gains and losses on asset sales are reflected in the income statement. Maintenance and repairs are charged to operations; additions, improvements and refurbishments are capitalized. Certain automotive property ($613,959 for 2003) is accounted for under capital leases. Amortization of such automobiles is included in depreciation expense. Accumulated amortization for automobiles was $158,957 at December 31, 2003

Regulatory asset and liabilities

TESI is subject to provisions of Financial Accounting Standards Board (FASB) Statement No. 71, "Accounting for the Effects of Certain Types of Regulation." Regulatory assets represent future revenues associated with certain costs that are expected to be recovered from customers through the ratemaking process. Regulatory liabilities represent probable future reductions in revenues associated with amounts that are expected to be credited to

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Regulatory asset and liabilities (continued)

customers through the ratemaking process. TESI does not have any regulatory liabilities. Regulatory assets recognized in the December 31, 2003 financial statement relate to deferred charges for professional fees incurred associated with rate change applications and proceedings. Such amounts are being amortized over five years on the straight-line method in accordance with regulatory directives. See Notes 5 and 13. In the event that a portion of TESI's operations is no longer subject to the provisions of FASB Statement No. 71, TESI would be required to write off the related regulatory assets that is not specifically recoverable through regulated rates. In addition, TESI would be required to determine if any impairment to the asset exists, including the write down of the asset to their estimated fair value. All deferred charges are reflected in rates.

Income taxes

TESI is taxed as a corporation for income tax purposes. TESI uses the asset and liability method of accounting for income taxes. Under the asset and liability method, deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to the differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income during the period that includes the enactment date.

Fair value of financial instruments

The carrying value of cash, receivables, accounts payable and accrued expenses approximate fair value due to the short-term maturity of these instruments. The carrying value of short and long-term debt approximates fair value based on the current rates offered for debt of comparable maturities and collateral requirements. None of the financial instruments are held for trading purposes.

Concentrations of credit risk

TESI's primary source of income is derived from the sale of water and wastewater services to individuals in six states. The customers are primarily residential users in subdivisions. At various times during the year, TESI's bank balances with financial institutions may exceed FDIC insurance limits. Management believes the risk is limited.

Advertising

Advertising costs, $501 for 2003, are charged to operations when incurred.

NOTE 2 - GOING CONCERN

As shown in the accompanying financial statements, TESI incurred a net loss of approximately $549,000 during the current period. TESI's current liabilities exceeded its current assets by approximately $17,650,000 and has an accumulated deficit of approximately $2,200,000. Furthermore, TESI is in default on its debt for certain covenant violations in its loan agreements, which causes TESI's long-term debt of approximately $16,800,000 to be callable at year end. See Note 7.

A going concern basis contemplates the realization of assets and the satisfaction of liabilities and commitments in the normal course of business. TESI's accumulated deficit has been funded from debt provided by its lending institutions, which is partially guaranteed by its parent company (SLECA). Since TESI is in default on its debt obligations, debt has been classified as a current liability in the financial statements.

Management intends to increase rates charged to customers and reduce operating costs to generate income which will eliminate the accumulated deficit and comply with the financial ratios in its debt agreements as well as complying with other required covenants. Management has obtained rate increases during 2004 to certain operations and anticipates additional applications for further rate increases to enhance its revenue base. Management believes the combination of these actions maximizes the probability of TESI's ability to remain in business.

Because it is unclear whether TESI will be successful in accomplishing these objectives, there is an uncertainty about TESI's ability to continue as a going concern. The financial statements do not include any adjustments that might be necessary should TESI be unable to continue as a going concern.

NOTE 3 - ACCOUNTS RECEIVABLE

Accounts receivables at December 31, 2003, consisted of the following:

	Amount
Trade accounts	$ 2,281,957
Unbilled receivables	348,888
	2,630,845
Less allowance for doubtful accounts	(1,887,708)
Net accounts receivable	$ 743,137

TESI does not require collateral on its receivables; however, a deposit is collected from customers which may be used to satisfy outstanding receivables. Receivables outstanding for longer than thirty (30) days have been considered uncollectible.

NOTE 4 - PROPERTY

Property, related service lives and accumulated depreciation at December 31, 2003, consisted of:

Description	Estimated Service Life	Amount
Land	-	$ 70,456
Office building	40 years	334,282
Water and waste water plants	10-40 years	24,979,426
Automotive	3-5 years	754,991
Office furniture and equipment	4-7 years	335,323
		26,474,478
Less accumulated depreciation		(5,943,298)
		$ 20,531,180

Depreciation expense amounted to $960,657 for 2003. Interest incurred on debt and capitalized as property was $39,165 for 2003. Essentially all property has been pledged to collateralize debt owed by TESI. See Note 7.

In accordance with regulatory accounting, certain assets reflected in water and wastewater plants relate to the recognition of adjustments for original costs of plant-in-service for utility plants in Pennsylvania as provided through the ratemaking process by the Pennsylvania Public Utility Commission. Accordingly, net plant in service assets of approximately $5,150,000 has been recognized. Additionally, no liabilities have been recorded in relation to the Pennsylvania Public Utility Commission order since none were identified in the ratemaking process; accordingly, the net amount has been reflected as paid-in-capital. See Note 13.

NOTE 5 - DEFERRED CHARGES

TESI's regulated operations are subject to FASB 71. Accordingly, TESI records assets that result from the regulated ratemaking process that would not be recorded under generally accepted accounting principles for non-regulated entities (See Note 1). TESI has recorded deferred charges for amortizable professional fees incurred relating to rate increase applications and proceedings to establish increased rates for water and wastewater services. See Note 13.

At December 31, 2003, deferred charges were $348,720 with related accumulated amortization of $77,982. Amortization expense for 2003 was $69,744.

NOTE 6 - NOTE PAYABLE

TESI financed certain insurance premiums with short-term financing arrangements. The note payable was payable with one payment of approximately $152,000 and nine installments of approximately $51,800, including interest, at 5.05% per annum. At December 31, 2003, TESI owed $608,629.

NOTE 7 - LONG-TERM DEBT

The components of long-term debt, at December 31, 2003, are comprised of the following:

National Cooperative Service Corporation (NCSC) (2), variable interest rate (3.2% at December 31, 2003), due in quarterly principal and interest installments of approximately $188,725, payable through 2020 to 2022, secured by property.	$ 9,962,950
Non-interest bearing note, due in six annual payments of $25,000 beginning April 2002 through 2007 (less imputed interest of $16,759 in 2003) - effective interest rate of 7.5%.	100,000
$3,519,939 line of credit, interest payable monthly for one year at 4.75% beginning July 2002 through 2003 and ending with a balloon payment in July 2005 and secured by TESI's property. At December 31, 2003, $133,000 was available on the line of credit.	3,386,938
Pennsylvania Infrastructure Investment Authority construction loan, secured by property. (See detailed explanation below.)	2,846,916
Automobile loan, non-interest bearing note, due in 60 monthly principal installments of approximately $357, beginning August 2002 through 2007.	16,046
4.9% notes payable (2) in 12 to 24 monthly installments ranging from $997 - $1,692, maturing from June 2004 to June 2005.	28,253
Capital leases payable (46) in 36 to 60 monthly installments from $234 to $465, maturing from December 2005 to October 2008, bearing interest from 5.5% to 11.9%, collateralized by vehicles.	447,831
Capital lease payable in 60 monthly installments of $661, beginning March 2001 through 2006, bearing interest at 9.9%, collateralized by equipment.	15,934
Total long-term debt	16,804,868
Less imputed interest	(16,759)
Net debt, current due to default	$ 16,788,109

NOTE 7 - LONG-TERM DEBT (CONTINUED)

Under these agreements, TESI is required to maintain certain operating financial ratios as well as other restrictive covenants and customary conditions to prevent default. Certain covenant violations occurred related to maintaining a minimum debt service coverage ratio and various required reporting to the lenders. TESI did not secure waivers from the lenders for these violations; therefore, all debt has been classified as current.

TESI has a multiple advance loan with NCSC of $10,500,000 scheduled to mature from 2020 to 2022. Advances totaling $10,275,000 have been received as of December 31, 2003. Loan advances are restricted to finance the acquisition and upgrade of TESI's water and sewer facilities. SLECA has guaranteed up to $1,600,000 of TESI's loan with NCSC.

TESI has a multiple advance construction loan of $3,108,000 with the Pennsylvania Infrastructure Investment Authority (PennVest) dated September 2002, bearing interest at a varying rate (2% at December 31, 2003) and scheduled to mature in March 2023. Loan advances are restricted to finance the construction of a sewer treatment facility in Pennsylvania. The loan is payable in equal monthly installments of principal and interest of $14,294 and matures on March 1, 2023. SLECA has guaranteed this loan in its entirety.

The debt, as disclosed above, is secured by property described in Note 4.

NOTE 8 - EMPLOYEE BENEFIT PLANS

TESI maintains a 401(k) profit sharing plan, which covers substantially all full-time employees. Contributions to the profit-sharing plan are discretionary as determined by management. The profit sharing plan also includes a provision under which eligible employees may defer up to a maximum of $12,000 of their annual compensation, pursuant to Section 401(k) of the Internal Revenue Code. TESI matches an electing participant's deferral of up to 3% of compensation. TESI made profit sharing contributions of $23,467 for the year ended December 31, 2003.

NOTE 9 - PROVISION FOR INCOME TAXES

The provision for income taxes consisted of the following for the year ended December 31, 2003:

Current tax provision:	
Current income taxes (refund)	$ -
Deferred income tax benefit	(68,000)
Income tax benefit	$ (68,000)

NOTE 9 - PROVISION FOR INCOME TAXES (CONTINUED)

The tax effects of temporary differences that give rise to significant portions of the deferred tax asset at December 31, 2003 are as follows:

Depreciation	$	(518,000)
Allowance for doubtful accounts		231,000
Net operating loss carryforward		1,021,000
Deferred tax asset	$	734,000

At December 31, 2003, TESI had a net operating loss carryforward of approximately $2.3 million that will expire from 2020 through 2023.

NOTE 10 - SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Cash payments for interest and income taxes for 2003 were as follows:

	Amount
Interest	$ 574,212
Income taxes	$ -

NOTE 11 - RELATED PARTY

During 2003, the Company incurred management fees from SLECA of $189,318 which were recorded as contributed capital. Additionally, TESI owed SLECA approximately $628,100 at December 31, 2003 for previously charged management fees, which includes personnel and benefits, computer support and transportation. There are no repayment terms associated with the obligation.

NOTE 12 - COMMITMENTS AND CONTINGENCIES

Litigation

Several suits and claims arising in the ordinary course of operations are pending against TESI. The majority of these claims are covered by insurance or other defenses; however, TESI has recorded a contingent liability to cover anticipated judgments.

NOTE 12 - COMMITMENTS AND CONTINGENCIES (CONTINUED)

Consent decrees

TESI, when purchasing the water and wastewater assets through the bankruptcy court, simultaneously concluded three consent decrees with various state and federal environmental regulatory agencies. The decrees state that TESI will make necessary refurbishments to bring existing systems into compliance with state and federal operating and environmental standards. It is the opinion of management that the refurbishments needed to meet the terms of the consent decrees can be completed within specified time limits. Costs associated with the refurbishments are expected to be capital in nature and are capitalized as incurred.

Environmental contingencies

Management of TESI is not aware of any unrecorded material environmental commitments or contingent environmental liabilities. Environmental contingencies have been mitigated by testing of the water and sewer systems on a regular basis and providing the test results to the proper environmental authorities. However, during 2003, penalties of approximately $20,000 were recorded for assessments made by environmental authorities.

NOTE 13 - PRIOR PERIOD ADJUSTMENTS

Certain corrections, related to the understatement of previously reported assets and the overstatement of expenses of prior years were recorded this year, resulting in a change to the previously reported additional paid-in-capital and the accumulated deficit as of December 31, 2002. An adjustment to record a net regulatory plant assets was made. See Note 4. Additionally, professional costs were capitalized for services associated with rate increase applications and proceedings. These amounts were approved for ratemaking purposes by the applicable public service commissions and will be recouped in future revenues. There was no tax effect of this change. The following depicts the changes in equity:

	Additional Paid-in Capital	Accumulated Deficit
As previously reported, December 31, 2002	$ 641,495	$ (1,699,022)
Recording of net regulatory assets for Pennsylvania plant in service	5,150,414	-
Capitalized professional services	-	60,741
As adjusted, December 31, 2002	$ 5,791,909	$ (1,638,281)

**INDEPENDENT AUDITORS' REPORT
ON SUPPLEMENTARY INFORMATION**

Board of Directors
Total Environmental Solutions, Inc. And Subsidiary
Baton Rouge, Louisiana

Our report on our audit of the basic financial statements of **TOTAL ENVIRONMENTAL SOLUTIONS, INC. AND SUBSIDIARY** for 2003 appears on page 1. Our audit was conducted in accordance with auditing standards generally accepted in the United States of America for the purpose of forming an opinion on the basic financial statements taken as a whole. Schedules 1, 2 and 3 are presented for the purpose of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Faulk & Winkler, LLC

Certified Public Accountants

Baton Rouge, Louisiana
June 25, 2004

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TOTAL ENVIRONMENTAL SOLUTIONS, INC. AND SUBSIDIARY

Baton Rouge, Louisiana

COMBINING SCHEDULE OF OPERATIONS

For the year ended December 31, 2003

	Regulated Operations	Nonregulated Operations	Total Operations
Revenues			
Water	$ 3,440,916	$ -	$ 3,440,916
Wastewater	6,172,742	167,039	6,339,781
Contract services	-	97,200	97,200
Total revenues	9,613,658	264,239	9,877,897
Operating expenses			
Water operating expenses:			
Employee salaries and benefits	723,642	-	723,642
Water plant operations	950,189	-	950,189
Contract services	161,175	-	161,175
Transportation	72,653	-	72,653
Depreciation and amortization	427,491	-	427,491
Bad debts	356,173	-	356,173
Legal	164,629	-	164,629
Taxes	115,162	-	115,162
Other	255,750	-	255,750
Total water expenses	3,226,864	-	3,226,864
Wastewater operating expenses:			
Employee salaries and benefits	864,673	-	864,673
Wastewater plant operations	1,550,776	-	1,550,776
Contract services	326,782	90,876	417,658
Transportation	51,453	-	51,453
Depreciation and amortization	568,092	-	568,092
Bad debts	599,992	124,098	724,090
Legal	38,056	-	38,056
Taxes	146,388	-	146,388
Other	219,076	-	219,076
Total wastewater expenses	4,365,288	214,974	4,580,262
General and administrative expenses:			
Management fees (SLECA)	189,318	-	189,318
Depreciation	34,818	-	34,818
Other	2,131,373	294	2,131,667
Total general and administrative expenses	2,355,509	294	2,355,803
Total operating expenses	9,947,661	215,268	10,162,929
Operating income (loss)	(334,003)	48,971	(285,032)
Other income (expenses)			
Interest expense	(560,273)	-	(560,273)
Interest income	3,066	-	3,066
Gain on sale of property	217,058	-	217,058
Other non-operating income	8,413	-	8,413
Total other expense, net	(331,736)	-	(331,736)
Income (loss) before income tax	(665,739)	48,971	(616,768)
Deferred tax benefit	68,000	-	68,000
Net income (loss)	$ (597,739)	$ 48,971	$ (548,768)

TOTAL ENVIRONMENTAL SOLUTIONS, INC. AND SUBSIDIARY

Baton Rouge, Louisiana

COMBINING SCHEDULE OF REGULATED OPERATIONS

For the year ended December 31, 2003

	Louisiana	Mississippi	North Carolina	Pennsylvania	South Carolina	Tennessee	Total
Revenues							
Water	$ 799,315	$ 1,139,021	$ 582,739	$ 751,640	$ 114,939	$ 53,262	$ 3,440,916
Wastewater	3,510,756	1,044,058	-	1,469,309	148,619	-	6,172,742
Total revenues	4,310,071	2,183,079	582,739	2,220,949	263,558	53,262	9,613,658
Operating expenses							
Water operating expenses:							
Employee salaries and benefits	211,102	219,317	50,306	186,231	47,385	9,301	723,642
Water plant operations	279,269	127,690	262,837	179,545	96,382	4,466	950,189
Contract services	47,110	65,260	2,993	8,598	35,807	1,407	161,175
Transportation	15,894	21,789	6,820	17,716	10,008	426	72,653
Depreciation and amortization	108,464	148,852	11,850	133,771	20,390	4,164	427,491
Bad debts	35,141	47,118	54,923	177,171	-	41,820	356,173
Legal	9,333	60,279	2,762	27,645	64,610	-	164,629
Taxes	41,299	5,296	16,141	39,087	7,881	5,458	115,162
Other	60,682	84,366	13,479	74,978	21,047	1,198	255,750
Total water expenses	808,294	779,967	422,111	844,742	303,510	68,240	3,226,864
Wastewater operating expenses:							
Employee salaries and benefits	622,578	149,549	24,100	47,108	21,338	-	864,673
Wastewater plant operations	740,555	304,142	5,270	453,770	47,039	-	1,550,776
Contract services	185,926	52,967	14,074	47,715	26,100	-	326,782
Transportation	30,206	2,914	91	16,098	2,144	-	51,453
Depreciation and amortization	284,544	91,898	3,594	171,442	16,614	-	568,092
Bad debts	233,022	86,912	24,394	255,664	-	-	599,992
Legal	8,329	3,849	-	13,808	12,070	-	38,056
Taxes	74,680	66,360	-	-	5,348	-	146,388
Other operating expenses	103,278	35,931	-	56,257	23,610	-	219,076
Total wastewater expenses	2,283,118	794,522	71,523	1,061,862	154,263	-	4,365,288
General and administrative expenses:							
Affiliated service charges:							
Management fees (SLECA)	67,416	31,181	21,279	58,897	4,865	5,680	189,318
Depreciation	19,294	5,510	2,828	5,784	645	757	34,818
Other	993,211	446,341	174,792	416,995	55,572	44,462	2,131,373
Total general and administrative expenses	1,079,921	483,032	198,899	481,676	61,082	50,899	2,355,509
Total operating expenses	4,171,333	2,057,521	692,533	2,388,280	518,855	119,139	9,947,661
Operating income (loss)	138,738	125,558	(109,794)	(167,331)	(255,297)	(65,877)	(334,003)
Other income (expenses)							
Interest expense	(273,038)	(149,428)	(4,704)	(120,994)	(12,109)	-	(560,273)
Interest income	3,066	-	-	-	-	-	3,066
Gain (loss) on sale of property	217,500	(442)	-	-	-	-	217,058
Other non-operating income	1,001	6,602	-	810	-	-	8,413
Total other expense, net	(51,471)	(143,268)	(4,704)	(120,184)	(12,109)	-	(331,736)
Income (loss) before income ta:	87,267	(17,710)	(114,498)	(287,515)	(267,406)	(65,877)	(665,739)
Deferred tax benefit	68,000	-	-	-	-	-	68,000
Net income (loss)	$ 155,267	$ (17,710)	$ (114,498)	$ (287,515)	$ (267,406)	$ (65,877)	$ (597,739)

TOTAL ENVIRONMENTAL SOLUTIONS, INC. AND SUBSIDIARY

Baton Rouge, Louisiana

COMBINING SCHEDULE OF NONREGULATED OPERATIONS

For the year ended December 31, 2003

	Lockhart	TES Management	Total
Revenues			
Wastewater	$ -	$ 167,039	$ 167,039
Contract services	97,200	-	97,200
Total revenues	97,200	167,039	264,239
Operating expenses			
Wastewater operating expenses:			
Contract services	90,876	-	90,876
Bad debts	-	124,098	124,098
Total wastewater expenses	90,876	124,098	214,974
General and administrative expenses	-	294	294
Total operating expenses	90,876	124,392	215,268
Net income (loss)	$ 6,324	$ 42,647	$ 48,971

TESI REBUTTAL EXHIBIT 4

LOUISIANA 8 TERREBONNE
SOUTH LOUISIANA ELECTRIC COOPERATIVE ASSOCIATION AND SUBSIDIARY

Supplementary Information

Year Ended December 31, 2002

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P. O. BOX 3695
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Bergeron & Lanaux
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A PROFESSIONAL CORPORATION

THOMAS J. LANAUX, CPA
MICHAEL D. BERGERON, CPA
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CLAUDE E. BERGERON, CPA
(RETIRED)

INDEPENDENT AUDITOR'S REPORT ON ADDITIONAL INFORMATION

The Board of Directors
South Louisiana Electric Cooperative Association and Subsidiary
Houma, Louisiana

Our report on our audits of the consolidated financial statements of Louisiana 8 Terrebonne South Louisiana Electric Cooperative Association and Subsidiary for 2002 and 2001 appears on page 3. Our audit was conducted for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The additional consolidating information for 2002 in Schedules 1 and 2 and the supplementary financial information of the subsidiary by division for 2002 in Schedules 3 is 4 is presented for purposes of additional analysis of the basic consolidated financial statements rather than to present the financial position and results of operations of the individual companies and divisions, and is not a required part of the basic consolidated financial statements. The accompanying schedule of expenditures of federal awards is presented for the purposes of additional analysis as required by the U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-profit Organizations, and is not required part of the general purpose financial statements. This additional information is the responsibility of the Cooperative's management. Such information has been subject to the auditing procedures applied in the audit of the basic 2002 consolidated financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the basic 2002 consolidated financial statements taken as a whole.

Bergeron & Lanaux

June 3, 2003

Schedule 1

LOUISIANA 8 TERREBONNE
SOUTH LOUISIANA ELECTRIC COOPERATIVE ASSOCIATION & SUBSIDIARY

Consolidating Balance Sheets

December 31, 2002

ASSETS

	SLECA	TESI	Eliminations	Consolidated
Utility plant:				
Electric plant in service	$ 73,847,632	$ -	$ -	$ 73,847,632
Construction work in progress	1,126,092	2,755,707	-	3,881,799
Water and waste water	-	10,104,378	-	10,104,378
	74,973,724	12,860,085	-	87,833,809
Less accumulated depreciation	(22,561,182)	(628,037)	-	(23,189,219)
Net utility plant	52,412,542	12,232,048	-	64,644,590
Other property and investments:				
Nonutility property:				
Building	157,837	-	-	157,837
Less accumulated depreciation	(138,874)	-	-	(138,874)
	18,963	-	-	18,963
Investment in subsidiary	(957,527)	-	957,527	-
Investments in associated organizations	1,820,755	-	-	1,820,755
Total other property and investments	882,191	-	957,527	1,839,718
Current assets:				
Cash and invested cash	11,428,486	152,636	-	11,581,122
Restricted cash	243,677	-	-	243,677
Cash and cash equivalents	11,672,163	152,636	-	11,824,799
Accounts receivable:				
Consumers, less allowance for doubtful accounts	1,890,529	794,466	-	2,684,995
Accrued unbilled revenue	1,389,180	217,438	-	1,606,618
Other accounts receivable	998,776	50,827	(628,122)	421,481
Materials and supplies inventories	748,226	-	-	748,226
Deferred income taxes	-	254,000	-	254,000
Prepayments	171,322	586,298	-	757,620
Total current assets	16,870,196	2,055,665	(628,122)	18,297,739
Other assets:				
Deferred income taxes	-	412,000	-	412,000
Deferred charges and other assets	23,397	-	-	23,397
Total other assets	23,397	412,000	-	435,397
Total assets	$ 70,188,326	$ 14,699,713	$ 329,405	$ 85,217,444

Schedule 1
(continued)

LOUISIANA 8 TERREBONNE
SOUTH LOUISIANA ELECTRIC COOPERATIVE ASSOCIATION & SUBSIDIARY

Consolidating Balance Sheets, Continued

December 31, 2002

LIABILITIES AND OTHER CREDITS	SLECA	TESI	Eliminations	Consolidated
Equities and margins:				
Memberships	$ 72,125	$ -	$ -	$ 72,125
Patronage capital	34,753,732	-	-	34,753,732
Other equities	196,029	(957,527)	957,527	196,029
Total equities and margins	35,021,886	(957,527)	957,527	35,021,886
Long-term obligations, net of current maturities:				
Notes and capital leases payable, net	19,834,804	11,964,252	-	31,799,056
Deferred interest payable	3,974,890	-	-	3,974,890
Long-term obligations, net	23,809,694	11,964,252	-	35,773,946
Current liabilities:				
Current maturities of long-term obligations	1,360,944	200,309	-	1,561,253
Other demand notes payable	-	384,583	-	384,583
Accounts payable:				
Purchased power	1,480,827	-	-	1,480,827
Other	506,738	2,468,287	(628,122)	2,346,903
Consumer deposits	808,735	405,142	-	1,213,877
Accrued expenses	1,027,118	234,667	-	1,261,785
Deferred revenue	610,436	-	-	610,436
Accumulated provision for rate refunds	1,234,935	-	-	1,234,935
Deferred credit - FEMA disaster funds	234,677	-	-	234,677
Total current liabilities	7,264,410	3,692,988	(628,122)	10,329,276
Other liability:				
Accumulated employee benefit liability	4,092,336	-	-	4,092,336
Total liabilities and other credits	$ 70,188,326	$ 14,699,713	$ 329,405	$ 85,217,444

Schedule 2

LOUISIANA 8 TERREBONNE
SOUTH LOUISIANA ELECTRIC COOPERATIVE ASSOCIATION & SUBSIDIARY

Consolidating Statements of Revenue and Expenses

Year Ended December 31, 2002

	SLECA	TESI	Eliminations	Consolidated
Operating revenue	$ 29,881,006	$ 8,785,477	$ -	$ 38,666,483
Operating expenses:				
Cost of power	18,285,100	-	-	18,285,100
Distribution expense	1,814,283	-	-	1,814,283
Consumer account expense	981,630	-	-	981,630
Customer sales and service	255,069	-	-	255,069
Depreciation and amortization	2,067,290	-	-	2,067,290
Water and waste water expenses	-	7,643,398	-	7,643,398
Other operating expenses	48,092	-	-	48,092
Taxes	70,156	-	-	70,156
Maintenance:				
Distribution and transmission system	1,285,973	-	-	1,285,973
General plant	239,512	-	-	239,512
Administrative and general:				
General office salaries and benefits	1,131,983	-	-	1,131,983
Property and liability insurance	89,774	-	-	89,774
Special services	100,180	-	-	100,180
Office supplies and expense	186,285	-	-	186,285
National, state and local meetings - directors and employees	84,252	-	-	84,252
Dues and subscriptions	164,576	-	-	164,576
Water and waste water expenses	-	2,507,345	-	2,507,345
Miscellaneous	78,559	-	-	78,559
	26,882,714	10,150,743	-	37,033,457
Operating margins	2,998,292	(1,365,266)	-	1,633,026
Interest expense	1,098,922	440,033	-	1,538,955
Net operating margins	1,899,370	(1,805,299)	-	94,071

Schedule 2
(continued)

LOUISIANA 8 TERREBONNE
SOUTH LOUISIANA ELECTRIC COOPERATIVE ASSOCIATION & SUBSIDIARY

Consolidating Statements of Revenue and Expenses, Continued

Year Ended December 31, 2002

	SLECA	TESI	Eliminations	Consolidated
Non-operating margins:				
Interest income	283,445	-	-	283,445
Income (loss) from equity investments	(694,577)	-	694,577	-
Other non-operating income (expenses), net	1,405,979	860,722	-	2,266,701
	994,847	860,722	694,577	2,550,146
	2,894,217	(944,577)	694,577	2,644,217
General and transmission cooperative capital credits:				
CFC	29,626	-	-	29,626
Net margins before income tax	2,923,843	(944,577)	694,577	2,673,843
Deferred tax benefit	-	250,000	-	250,000
Net margins	$ 2,923,843	$ (694,577)	$ 694,577	$ 2,923,843

Total Environmental Solutions, Inc.
A Subsidiary of South Louisiana Electric Cooperative Association
Balance Sheet by Division (State)
December 31, 2002

	Louisiana	Mississippi	North Carolina	Pennsylvania	South Carolina	Tennessee	Total
ASSETS							
Current assets:							
Cash	$ 152,436	$ 200	$ -	$ -	$ -	$ -	$ 152,636
Accounts receivable:							
Consumers, less allowance for doubtful accounts	317,578	202,452	48,603	205,084	8,049	12,700	794,466
Accrued unbilled revenue	33,601	7,928	47,841	128,068	-	-	217,438
Other receivables, net	50,827	-	-	-	-	-	50,827
Deferred income taxes	254,000	-	-	-	-	-	254,000
Prepaid expenses	572,108	9,742	1,158	1,200	975	1,115	586,298
Total current assets	1,380,550	220,322	97,602	334,352	9,024	13,815	2,055,665
Utility plant:							
Water and wastewater plant in service	4,925,765	3,506,848	314,905	982,212	214,264	160,384	10,104,378
Construction work in progress	5,136	471,522	-	2,279,049	-	-	2,755,707
	4,930,901	3,978,370	314,905	3,261,261	214,264	160,384	12,860,085
Less accumulated depreciation	(366,833)	(172,415)	(17,660)	(52,791)	(10,501)	(7,837)	(628,037)
Net utility plant	4,564,068	3,805,955	297,245	3,208,470	203,763	152,547	12,232,048
Other assets:							
Deferred income taxes	412,000	-	-	-	-	-	412,000
Total assets	$ 6,356,618	$ 4,026,277	$ 394,847	$ 3,542,822	$ 212,787	$ 166,362	$ 14,699,713
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)							
Current liabilities:							
Current maturities of long-term obligations	$ 88,602	$ 6,024	$ -	$ 105,683	$ -	$ -	$ 200,309
Demand notes payable	384,583	-	-	-	-	-	384,583
Accounts payable	708,191	-	-	-	-	-	708,191
Accounts payable construction	-	-	-	1,131,974	-	-	1,131,974
Due to parent company	628,122	-	-	-	-	-	628,122
Due to/from other divisions	(6,700,404)	4,182,549	745,145	971,277	541,440	259,993	-
Consumer deposits	339,728	59,860	-	5,554	-	-	405,142
Accrued expenses	224,868	9,075	-	724	-	-	234,667
Total current liabilities	(4,326,310)	4,257,508	745,145	2,215,212	541,440	259,993	3,692,988
Long-term obligations, net of current maturities	11,289,937	15,934	-	658,381	-	-	11,964,252
Total liabilities	6,963,627	4,273,442	745,145	2,873,593	541,440	259,993	15,657,240
Stockholder's equity (deficit):							
Common stock	100,000	-	-	-	-	-	100,000
Additional paid in capital	641,495	-	-	-	-	-	641,495
Retained earnings (deficit)	(1,348,504)	(247,165)	(350,298)	669,229	(328,653)	(93,631)	(1,699,022)
Total stockholder's equity (deficit)	(607,009)	(247,165)	(350,298)	669,229	(328,653)	(93,631)	(957,527)
Total liabilities and stockholder's equity (deficit)	$ 6,356,618	$ 4,026,277	$ 394,847	$ 3,542,822	$ 212,787	$ 166,362	$ 14,699,713

Schedule 4

Total Environmental Solutions, Inc.
A Subsidiary of South Louisiana Electric Cooperative Association
Statement of Revenue and Expenses by Division (State)
December 31, 2002

	Louisiana	Mississippi	North Carolina	Pennsylvania	South Carolina	Tennessee	Total
Revenue:							
Water revenue	$ 562,081	$ 1,027,891	$ 589,645	$ 790,482	$ 70,831	$ 54,568	$ 3,095,498
Wastewater revenue	3,304,504	886,409	-	1,235,512	263,554	-	5,689,979
Total revenue	3,866,585	1,914,300	589,645	2,025,994	334,385	54,568	8,785,477
Operating expenses:							
Water operating expenses:							
Employee salaries and benefits	174,923	226,704	116,289	164,565	17,934	7,974	708,389
Water plant operations	356,146	218,951	335,758	161,446	87,295	5,074	1,164,670
Contract services	37,064	187,849	6,738	82,557	83,608	16,131	413,947
Transportation	132,799	79,969	13,932	53,748	4,116	1,417	285,981
Insurance	16,878	28,650	9,149	16,254	5,412	1,182	77,525
Depreciation	30,360	83,865	7,581	20,817	4,293	3,965	150,881
Other operating expenses	22,447	5,921	7,701	13,285	12,045	390	61,789
Total water expenses	770,617	831,909	497,148	512,672	214,703	36,133	2,863,182
Wastewater operating expenses:							
Employee salaries and benefits	1,041,969	196,253	-	257,396	27,585	-	1,523,203
Wastewater plant operations	797,790	369,593	9,247	385,024	51,670	-	1,613,324
Contract services	239,764	206,089	9,628	72,272	150,177	-	677,930
Transportation	178,825	50,227	390	29,841	6,059	-	265,342
Insurance	100,331	24,801	-	25,424	8,323	-	158,879
Depreciation	229,505	47,152	2,192	11,621	1,960	-	292,430
Other operating expenses	217,232	5,899	5,000	13,347	7,630	-	249,108
Total waste water expenses	2,805,416	900,014	26,457	794,925	253,404	-	4,780,216
General and administrative expenses							
Employee salaries and benefits	249,580	115,235	59,845	71,248	21,174	15,785	532,867
Provision for uncollectible accounts	71,746	24,232	72,715	309,794	2,780	41,405	522,672
Other general and administrative expenses	561,717	269,299	126,048	404,017	59,202	31,523	1,451,806
Total general and administrative expenses	883,043	408,766	258,608	785,059	83,156	88,713	2,507,345
Total operating expenses	4,459,076	2,140,689	782,213	2,092,656	551,263	124,846	10,150,743
Operating income (loss)	(592,491)	(226,389)	(192,568)	(66,662)	(216,878)	(70,278)	(1,365,266)
Interest expense	236,081	78,643	22,469	71,729	14,259	16,852	440,033
Net operating income (loss)	(828,572)	(305,032)	(215,037)	(138,391)	(231,137)	(87,130)	(1,805,299)
Other non-operating income (expense), net	105,001	353,219	1,063	401,439	-	-	860,722
Income (loss) before income tax	(723,571)	48,187	(213,974)	263,048	(231,137)	(87,130)	(944,577)
Deferred tax benefit (expense)	192,000	(13,000)	57,000	(70,000)	61,000	23,000	250,000
Net income (loss)	$ (531,571)	$ 35,187	$ (156,974)	$ 193,048	$ (170,137)	$ (64,130)	$ (694,577)

LOUISIANA 8 TERREBONNE
SOUTH LOUISIANA ELECTRIC COOPERATIVE ASSOCIATION AND SUBSIDIARY

Supplementary Financial Reports

Year Ended December 31, 2002

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
LOUISIANA 8 TERREBONNE
SOUTH LOUISIANA ELECTRIC COOPERATIVE ASSOCIATION & SUBSIDIARY
Year ended December 31, 2002

Federal Granting Agency/Recipient State Agency/Grant Program	GRANT NUMBER	CFDA NUMBER	REVENUE REALIZED	EXPENDITURE AMOUNT
FEDERAL EMERGENCY MANAGEMENT AGENCY				
Pass through payment from State Department of Emergency Preparedness				
Hazard Mitigation Grant	N/A	83.548	$ 325,224	$ 325,224
Total - Federal Emergency Management Agency			325,224	325,224
Total program revenue and expenditures			$ 325,224	$ 325,224

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Note 1: BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards includes the federal grant activity of South Louisiana Cooperative Association and Subsidiary and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of the basic financial statements.

LOUISIANA 8 TERREBONNE
SOUTH LOUISIANA ELECTRIC COOPERTIVE ASSOCIATION AND SUBSIDARY
SCHEDULE OF FINDS AND QUESTIONED COST
YEAR ENDED DECEMBER 31, 2002

A) SUMMARY OF AUDIT RESULTS

1. The auditor's report expresses an unqualified opinion on the financial statements of Louisiana 8 Terrebonne South Louisiana Electric Cooperative Association and Subsidiary.

2. A reportable condition relating to the audit of the financial statements is reported in the Report on Compliance and on Internal Control over Financial Reporting Based on an Audit of the Financial Statements in Accordance with Government Auditing Standards. The condition is reported as a material weakness.

3. No instances of noncompliance material to the financial statements of Louisiana 8 Terrebonne South Louisiana Electric Cooperative Association and Subsidiary were disclosed during the audit

4. No reportable conditions relating to the audit of the major federal award program were reported in the Report on Compliance with Requirements Applicable to the Major Program and Internal Control over Compliance in Accordance with OMB Circular A-133.

5. The auditor's report on compliance for the major federal award program for Louisiana 8 Terrebonne South Louisiana Electric Cooperative Association and Subsidiary expresses an unqualified opinion.

6. No findings relative to the major federal award program for Louisiana 8 Terrebonne South Louisiana Electric Cooperative Association and Subsidiary are reported in Part C of this Schedule.

7. The following program was tested as a major program:

   Federal Emergency Management Agency
   Hazard Mitigation Grant CFDA # 83.548

8. The threshold for distinguishing Type A and B programs was $300,000.

9. Louisiana 8 Terrebonne South Louisiana Electric Cooperative Association and Subsidiary was not determined to be a low-risk auditee.

B) FINDINGS - FINANCIAL STATEMENT AUDIT

2002-01 Accounting Records of Subsidiary

Condition and criteria: The balances of some general ledger accounts of the Cooperative's wholly owned subsidiary were misstated. We proposed audit adjustments, which were accepted by management, to correct these misstatements. Our preliminary evaluation of internal control over financial reporting indicated that while significant improvements in control procedures had been implemented during the audit period, controls were not effective in preventing the misstatement of general ledger account balances.

Cause: The subsidiary has been in business for only two years and was formed to acquire the assets of a company in bankruptcy. Management had originally planned to maintain approximately twelve separate profit centers within the general ledger, but after acquiring the assets and starting business, they learned that regulators would require the company to maintain separate profit centers for each of the approximately 300 water and wastewater systems acquired. Such a requirement added significantly to the complexity of maintaining the general ledger. Efforts to improve the accounting system and implement controls have been ongoing since the acquisition, but the process has been slow. The conversion of the computer system, requests for information from regulators, the high volume of transactions and the requirement of the regulators to account separately for each water and wastewater treatment facility have contributed to the difficulty of establishing proper controls. We have learned that management expects to be able to consolidate the profit centers within a state as uniform rates are approved by that state's regulatory body. This should significantly reduce the volume of transactions and the complexity of the general ledger.

Effect: The weaknesses in internal controls over financial reporting could affect the reliability of internal financial information prepared from the general ledger for management and the board and hinder the organization's ability to make strategic business decisions and safeguard its assets.

Recommendations: Since acquiring the assets of the company in bankruptcy, management has been working to improve the overall condition of the company's financial records. We noted considerable improvement by the end of our audit fieldwork, especially in the timeliness of month end closing procedures and management review of proper coding of transactions in general ledger accounts. We recommend management continue to focus on improving the overall condition of the accounting system and records, especially in the following areas:

- Work order and inventory control systems – Implementing systems to capture direct and indirect costs of improving and operating the various water and sewer systems would improve the financial information system.

- Staffing – The complexity of the general ledger, the number of customers and the volume of transactions have exceeded management's original expectations. In addition, complying with regulatory requests for information in connection with rate cases requires significant staff time. Management should evaluate the staffing level of the accounting and billing departments to determine whether additional staffing is needed.
- Accounts Payable – Procedures should be established to ensure proper cut off at year-end.
- Billing and Accounts Receivable – Procedures should be reviewed and modified as necessary to facilitate a more efficient reconciliation of billing summaries and cash receipts to revenues and accounts receivable on the general ledger.
- Customer account records and customer deposits – Procedures should be established to review and verify the accuracy of customer deposit records.

Management's response: We have reviewed the recommendations of our auditors and we are working diligently toward improving the overall condition of our financial records and our internal control over financial reporting. We are in the process of addressing the concerns of the auditors and implementing control procedures.

C) FINDINGS AND QUESTIONED COSTS – MAJOR FEDERAL AWARD PROGRAM AUDIT

None

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(Retired)

REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

The Board of Directors
South Louisiana Electric Cooperative Association and Subsidiary
Houma, Louisiana

We have audited the financial statements of Louisiana 8 Terrebonne South Louisiana Electric Cooperative Association and Subsidiary as of and for the years ended December 31, 2002 and 2001, and have issued our report thereon dated, June 3, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether Louisiana 8 Terrebonne South Louisiana Electric Cooperative Association and Subsidiary's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Louisiana 8 Terrebonne South Louisiana Electric Cooperative Association and Subsidiary's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Louisiana 8 Terrebonne South Louisiana Electric Cooperative Association and Subsidiary's ability to record, process, summarize and report financial data consistent with the assertions of management in the general purpose financial statements. A reportable condition is described in the accompanying schedule of findings and questioned costs as item 2002-01.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the general purpose financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we consider the reportable condition reported in item 2002-01 to be a material weakness. We also noted other matters involving the internal control over financial reporting that we have reported to the management of Louisiana 8 Terrebonne South Louisiana Electric Cooperative Association and Subsidiary in a separate letter dated June 3, 2003.

This report is intended for the information of the Board of Directors, management, the Rural Utilities Service and supplemental lenders and is not intended to be and should not be used by anyone other than these specified parties.

June 3, 2003

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INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

The Board of Directors
South Louisiana Electric Cooperative Association and Subsidiary
Houma, LA

Compliance

We have audited the compliance of Louisiana 8 Terrebonne South Louisiana Electric Cooperative Association and Subsidiary with the types of compliance requirements described in the U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to its major federal program for the year ended June 30, 2002. Louisiana 8 Terrebonne South Louisiana Electric Cooperative Association and Subsidiary's major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to its major federal program is the responsibility of Louisiana 8 Terrebonne South Louisiana Electric Cooperative Association and Subsidiary's management. Our responsibility is to express an opinion on Louisiana 8 Terrebonne South Louisiana Electric Cooperative Association and Subsidiary's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Louisiana 8 Terrebonne South Louisiana Electric Cooperative Association and Subsidiary's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on Louisiana 8 Terrebonne South Louisiana Electric Cooperative Association and Subsidiary's compliance with those requirements.

In our opinion, Louisiana 8 Terrebonne South Louisiana Electric Cooperative Association and Subsidiary complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended December 31, 2002.

Internal Control Over Compliance

The management of Louisiana 8 Terrebonne South Louisiana Electric Cooperative Association and Subsidiary is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered Louisiana 8 Terrebonne South Louisiana Electric Cooperative Association and Subsidiary's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended for the information and use of the Board of Directors, management, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

June 26, 2003

Bergeron & Lanaux

TOTAL ENVIRONMENTAL SOLUTIONS, INC.

Analysis of Staff's Revenue Requirement Position Based Upon the Direct Testimony

Analysis Does Not Include an Operating Margin or the Gross Up for Income Taxes

Utility System	Revenue at Present Rates	Operating Revenue Deductions	Revenue Increase	Total Revenue at Proposed Rates
Sewer System	$144,657	$152,561	$7,904	$152,561
Add:				
Operating Margin			0	0
Income Taxes			0	0
Total Staff Sewer Revenue Requirement	$144,657	$152,561	$7,904	$152,561
Water System	$108,267	$234,747	$126,480	$234,747
Add:				
Operating Margin			0	0
Income Taxes			0	0
Total Staff Water Revenue Requirement	$108,267	$234,747	$126,480	$234,747
Total Combined Revenue Requirement	$252,924	$387,308	$134,384	$387,308

Financial Effect on Operations	
Net Operating Loss Fiscal Year 2003 (Audited)	($267,406)
Add:	
Staff Revenue Increase (Before Margins or Income Taxes)	134,384
Net Effect to Operations - Pro Forma	**($133,022)**
Consideration of Additional Staff Adjustments:	
Add:	
Confiscation of Plant Installed (2001- 2002)	($174,757)
Retroactive Rate Making (Connection/Tap Fees)	(19,300)
Retroactive Rate Making (Enhancement Fees)	(351,456)
Financial Impact of Staff Rate Base Adjustments	**($678,535)**
Combined Operating Losses (2001 - 2003)	**(692,040)**
Total Financial Impairment	**($1,370,575)**

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TOTAL ENVIRONMENTAL SOLUTIONS, INC.

Comparison of Staff Operating Revenues, Operating Margins & Actual 2003 Net Operating Loss

	Operating Margins							
	0%	5%	10%	15%	20%	25%	30%	31.71%
Operating Margin - Total Revenue	$385,303	$411,093	$440,993	$483,643	$547,543	$632,043	$746,493	$788,433
Staff Revenue Requirements:								
Operating Revenue Deductions Before Income Taxes	387,308	387,308	387,308	387,308	387,308	387,308	387,308	387,308
Operating Margin Revenue & Income Taxes	($2,005)	$23,785	$53,685	$96,335	$160,235	$244,735	$359,185	$401,125
Add:								
Additional Revenue Per Staff	134,384	134,384	134,384	134,384	134,384	134,384	134,384	134,384
Total Additional Annual Revenue Available to TESI	$132,379	$158,169	$188,069	$230,719	$294,619	$379,119	$493,569	$535,509
Audited 2003 Net Operating Loss	267,406	267,406	267,406	267,406	267,406	267,406	267,406	267,406
Revenue Margins or Deficiencies	($135,027)	($109,237)	($79,337)	($36,687)	$27,213	$111,713	$226,163	$268,103

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